FIA European Principal Traders Association
T 31 611 878984
epta.fia.org

June 4, 2015

ONLINE SUBMISSION:

European Banking Authority
One Canada Square (Floor 46)
Canary Wharf
London E14 5AAl UK

Re: Draft Guidelines on sound remuneration policies under Article 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013

1. Summary:

FIA EPTA[1] would like to thank the EBA for the invitation to respond to its proposals on sound remuneration in the Consultation Paper EBA/CP/2015/03. We do not agree with the EBA's interpretation of proportionality in this context, which is a radical departure from the application under previous CEBS[2] guidelines that we consider, firstly, inappropriate with respect to investment firms engaged solely in proprietary trading, and secondly, inconsistent with CRD IV.[3]

We urge the Authority to suggest to the European Commission legislative amendments, including to Articles 92-94 to exclude investment firms engaged solely in proprietary trading. In the interim, pending application of those amendments, we ask the EBA to support our call on the Commission to bring forward delegated acts providing a temporary derogation from the provisions of Article 92 for such investment firms.

The concerns that the EBA recognises with respect to the impact of the application of all remuneration principles to all institutions, particularly to small and non-complex institutions,[4] also hold true for investment firms engaged solely in proprietary trading. Applying Articles 92-94 of CRD IV as minimum requirements would have a serious, detrimental impact on these firms, a great many more of which will be brought into scope through new MiFID 2[5] provisions in 2017.

[1] The European Principal Traders Association (EPTA) is affiliated with the Futures Industry Association (FIA) and is comprised of 26 EU-based proprietary trading firms that deal on own account on trading venues across Europe. FIA EPTA members engage in manual, automated and hybrid methods of trading and are active in a variety of asset classes, such as equities, foreign exchange, commodity derivatives and fixed income. The main business activity of FIA EPTA member firms is market making, and as such our members are a critical source of liquidity in the on-venue markets.
More than any other type of market participant, FIA EPTA members and other proprietary trading firms are the investment firms that will fulfill the obligations imposed by MiFID 2 on market makers to provide continuous liquidity to European markets. Market makers play a crucial role, allowing those who use the markets to manage their business risks to enter and exit the markets efficiently. Market makers absorb investors' needs for immediate demand or supply of a financial instrument, while competition among market makers reduces the bid-ask spread. Likewise, market makers contribute significantly to reducing transaction costs for end investors, both on-venue and in the economy generally.

[2] Committee of European Banking Supervisors

[3] DIRECTIVE 2013/36/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("CRD IV").

[4] Consultation Paper EBA/CP/2015/03, Executive Summary, p. 6.

[5] DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) ("MiFID 2").

2. Concerns regarding draft guidelines and proposed approach:

Our members raise significant concerns with the EBA's radical departure from past practice regarding the application of proportionality from the Draft Guidelines on sound remuneration policies, as follow:

(A) It will severely and adversely impact proprietary trading firms' business models and both risk and prudential management:

> (A)(1) Because a large component of variable compensation is key to these firms' ability to compete with large financial institutions in attracting talented staff;
> (A)(2) Because variable compensation supports a flexible cost base that enables such firms to respond in a prudentially responsible manner to unpredictable revenue streams;
> (A)(3) Because firms structured as partnerships (relevant for many of our members) may be adversely affected;

(B) These impacts will ultimately impede proprietary trading firms in complying with key MIFID 2 requirements; and,

(C) The EBA's and the Commission's preliminary view on proportionality appears to be plainly contrary to the express wording of the CRD IV text as well as the concept of proportionality under the Treaty on European Union.

(A) Severe and adverse impact on the business models of proprietary trading firms that disrupts appropriate and balanced incentives for risk taking:

Compliance with the fixed-to-variable pay ratio would require proprietary trading firms to increase fixed salaries across all staff in a manner anathema to the flexible compensation structures that currently aid such firms' risk management.

Unlike banks that have steady and substantial contract-based revenue from client business, proprietary trading firms' revenues are highly volatile and dependent on market conditions. Because of this, remuneration structures within the proprietary trading sector generally comprise low fixed salaries with a potentially high variable component if the firm, and/or the relevant individual, performs well. Bonus schemes discourage excessive risk-taking behaviour, as they are directly tied to compliance with the firm's risk appetite. In addition payments are typically discretionary so that firms are not limited in their ability to strengthen or protect their limited capital base, whilst retaining staff in times of economic stress.

It is important to remember proprietary trading firms are fundamentally different to banks:

- Their risk profile deviates significantly as they do not hold client money / assets; they have no clients and no transactions with retail investors; as such a failure is contained and resolution is straightforward;
- Given that they are owner-operated businesses, their approach to risk is fundamentally different to firms with a large dependence on external and often public funding;
- No government funds will be made available to bail them in or out in the event of failure because on an individual basis, the demise of any single proprietary trading firm would not have systemic consequences for the market; failure will only impact the firm's owners;

- They have no regular, contract-based income; P&L starts at zero each month; any income or loss derives from market transactions;
- They predominantly operate in "lit" markets (trading platforms such as stock exchanges where the central order book is public) and trade highly liquid instruments, so liquidation risks, such as those that arise for example when banks must dispose of assets in distressed lending portfolios, are highly unlikely to apply;
- Most risks are hedged in real time, often through different instruments with offsetting risk profiles, and will be mitigated once a trade is submitted to clearing and settlement;
- General clearing members and central counterparties guarantee their activity, which greatly limits the effects of a failure;
- They are much smaller than banks: their funding profile matches their asset base; asset, funding and risk cycles are much shorter than with banks (P&L realises within days not years, so there is no need for deferred payments to mitigate risk taking).

By enforcing a ratio on compensation of 1:1 (max 2:1) variable to fixed, proprietary trading firms will see a significant increase in their cost base without cause. Our internal analysis shows firms' **fixed compensation costs could increase by three to four times their current level, while greatly damaging the flexibility and risk-mitigating effects of discretionary variable compensation**. This is a dramatic impact that will inevitably hamstring such firms' ability to reduce costs during stress events or downturns.

(A)(1) Impact on competitiveness of proprietary trading firms in a global market:

For the reasons set out above, proprietary trading firms cannot compete with credit institutions for employees on the basis of fixed salaries. Nevertheless, they have historically been able to attract a fair share of skilled staff due to a flexible compensation structure with variable, discretionary bonus relating to the firms' performance. Restricting flexibility in this regard will render such firms non-competitive both with banks and non-EU trading firms, and this will in turn harm their ability to fulfill key roles and obligations under MiFID 2.

Further, if remuneration requirements apply to proprietary trading entities outside Europe where such are part of a CRD IV group, this will put European-headquartered trading groups at a severe competitive disadvantage compared to the US and Asia. No other major jurisdiction has contemplated or is contemplating such prescriptive and restrictive remuneration requirements or compensation limits for their financial services firms.

(A)(2) Impact on proprietary trading firms' ability to respond in a prudentially responsible manner to unpredictable revenue streams:

From a prudential perspective, adhering to the guidelines on remuneration without proportionality would have the consequence of diverting capital that proprietary trading firms currently use to support market risk, liquidity provision and business growth, to managing increased fixed overheads. In the context of recovery and resolution planning, these firms (with a simpler business model than banks) will not require external funding or government assistance to recover, but will look to adjust their variable cost base and manage profit/loss through a recovery period to avoid liquidation. Thus, having flexibility on variable remuneration supports such firms in applying realistic recovery plans pursuant to CRR[6] and, in turn, achieving business continuity pursuant to MiFID 2; likewise, increased fixed overheads will thwart these same firms in achieving sound recovery and resolution measures.

(A)(3) Impact on partnership structures:

[6] REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on prudential requirements for credit institutions and investment firms ("CRR").

FIA EPTA members are often set up as partnerships or Limited Liability Partnerships ("LLP"), given their entrepreneurial nature and small size. FIA EPTA has concerns with the EBA's intention to broaden remuneration scope to include "*payments made or benefits, monetary or non-monetary, awarded directly by or on behalf of institutions in exchange for professional services rendered by staff, … and other payments made via methods and vehicles which, if they were not considered as remuneration, would lead to a circumvention of remuneration requirements*." This introduces significant uncertainty around how the variable to fixed ratios would be computed, and how malus and clawback would be defined. FIA EPTA requests that the EBA clarify its position related to this point.

(B) Impact on proprietary trading firms' ability to comply with key MIFID 2 requirements:

FIA EPTA members are fully committed to Europe's goal of building stronger, deeper and more diversified capital markets and to serving them in the capacity of market makers. More than any other type of market participant, FIA EPTA members and other proprietary trading firms are the investment firms that will fulfill the obligations imposed by MiFID 2 on market makers to provide continuous liquidity to European markets.

High fixed remuneration costs, however, may impede proprietary trading firms from this role. Many proprietary trading firms will not be able to commit a larger amount of capital to salary/"fixed" profit share payments, as this would overly restrict their ability to limit total remuneration in difficult times and maintain profitability or even break even in periods of underperformance or market downturns.

We note in the latest consultation on MiFID 2, ESMA stated its decision not to include certain organisational requirements in market making requirements - *including having in place a dedicated remuneration scheme for staff involved in market making* - because of concerns expressed by respondents.[7] Such requirements could actually preclude firms from market making in compliance with MiFID 2 Article 17(1) and 17(3)(c) requirements,[8] in contravention to the legislative intent and to the detriment of liquidity across European trading venues.

(C) The EBA's and the Commission's preliminary view on proportionality appears to be plainly contrary to the express wording of the CRD IV text as well as constituting a radical departure from past practice:

- Recital 66[9] of CRD IV calling for proportionate application and permitting neutralisations was included in the legislation to guide persons applying provisions therein and does not need support in 'operative provisions';
- The EBA's approach constitutes a radical departure from past practice based on equivalent text in CRD III;[10]

[7] ESMA Consultation Paper MiFID II/MiFIR 19 December 2014 I ESMA/2014/1570, p. 388.

[8] "*An investment firm that engages in algorithmic trading shall have in place effective systems and risk controls suitable to the business it operates*," Article 17(1) MiFID 2; and "*The investment firm shall have in place effective business continuity arrangements to deal with any failure of its trading systems*," ibid.; and "*An investment firm that engages in algorithmic trading to pursue a market making strategy shall, taking into account the liquidity, scale and nature of the specific market and the characteristics of the instrument traded: (c) have in place effective systems and controls to ensure that it fulfils its obligations under the agreement referred to in point (b) at all times*," Article 17(3)(c) MiFID 2.

[9] Recital (66) of CRD IV states that 'The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their size, internal organisation and the nature, scope and complexity of their activities. In particular ***it would not be proportionate to require certain types of investment firms to comply with all of those principles***.' [our emphasis]

- If the co-legislators had intended the remuneration provisions to be directly applicable as minimum requirements, they would have included these in the regulation, and not the directive; and
- The EBA's concern in its Cost Benefit Analysis that requiring all provisions to be applied by all institutions would lead to significant costs and unintended consequences on the structure of the remuneration schemes for specific types of investment firms apply equally to proprietary trading firms.

3. Conclusion: given the specific characteristics of investment firms that engage solely in proprietary trading, a proportionate approach to remuneration for these firms must remain as part of CRD IV:

FIA EPTA strongly believes a proportionate approach to remuneration for investment firms that engage solely in proprietary trading is required so that such firms can continue to manage their risk, offer appropriate and balanced incentives for risk taking, and comply with key MIFID 2 requirements. Proportionality is justified in this case because the objective of CRD IV – promoting the safety and soundness of banks' activity post-crisis – is not relevant to proprietary trading firms to the same degree given the fundamental difference in business model.

We urge the Authority to suggest to the European Commission legislative amendments, including to Articles 92-94 to exclude investment firms engaged solely in proprietary trading. In the interim, pending application of those amendments, we ask the EBA to support our call on the Commission to bring forward delegated acts providing a temporary derogation from the provisions of Article 92 for such investment firms. Without interim relief, the application of Articles 92-94 of CRD IV as minimum requirements would have a serious, detrimental impact on these firms, a great many more of which will be brought into scope through MiFID 2 provisions as of 2017.

[10] DIRECTIVE 2010/76/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies ("CRD III").

3. Written responses to select questions in Consultation Paper EBA/CP/2015/03:

Q 1: Are the definitions provided sufficiently clear; are additional definitions needed?

It is FIA EPTA's view that both (i) partners or members in an investment firm that is organised as a limited liability partnership or limited partnership and (ii) employees who own common equity of an investment firm where the investment firm is organised as a limited liability company, do not fall within the scope of Identified Staff.

FIA EPTA request the EBA to confirm this understanding or otherwise clarify the circumstances in which partnership profits or shareholder distributions would not be considered to be within scope.

Q 3: Are the guidelines regarding the shareholders' involvement in setting higher ratios for variable remuneration sufficiently clear?

FIA EPTA believes the guidelines in Article 6 addressing the 'Governance of Remuneration' are generally too prescriptive. In particular with respect to the 'Responsibilities, design, approval and oversight of the remuneration policy' (Article 6.1), we consider EBA's guidelines should adhere to the principle articulated in paragraph 24 that risk and compliance functions should have significant input into the setting of bonus pools, without overly detailing how this should be implemented by individual firms.

The EBA's current level of prescription fails to consider the nature, scale and complexity of different (namely small to medium) investment firms within scope of these provisions and do not make sense for such firms. This supports our belief that the provisions are in fact intended for banks and large credit institutions, rather than smaller investment firms.

For example, specific references in paragraph 26 to the input required from competent corporate functions and bodies into the remuneration policy do not take into account that small to medium investment firms may not have staff to fill all the roles enumerated; this will cause confusion among such firms as to how to implement the provisions and whether they are in compliance. Further, paragraph 28 regarding ex-post adjustments that must be made by the risk management function does not appropriately consider the business model of investment firms engaged solely in proprietary trading. Such firms trade on own account, on-venue, in liquid financial instruments with a limited time horizon; results are immediately reflected in the P/L and thus can be determined on a real-time intraday basis without risk of a negative adjustment at a later stage. For such firms, no ex-post risk adjustment needs to take place.

Q 4: Are the guidelines regarding remuneration policies and group context appropriate and sufficiently clear?

As a general point, FIA EPTA believes the Draft Guidelines in this respect[11] will have an extraterritorial impact that infringes on customary international law principle against extraterritoriality insofar as they apply to EU financial institutions at group, parent company and subsidiary levels, including entities established outside the EU. To minimise this effect, we urge the EBA at a minimum to clarify that persons employed by a parent company that is based in a

[11] Page 37, paragraph 69: "*Where an institution established in a Member State is a subsidiary of a parent institution in a third country, the CRD requirements apply to that institution. This includes, where applicable, the application on a sub-consolidated or consolidated level and to subsidiaries, but does not include the level of the parent institution located in a third country and other subsidiaries of that parent institution located in third countries. The consolidating institution should ensure that the group-wide remuneration policies of the parent institution in a third country are taken into consideration within its own remuneration policies as far as this is not contrary to the requirements set out in CRD, CRR, national law and applicable guidelines.*"

third country who exercise only indirect influence on the risk profile of an investment firm established in an EU Member State fall outside scope of these guidelines. Further, the EBA should confirm that for group staff in other entities within the scope of consolidation, only that portion of their compensation dedicated to the relevant investment firm established in an EU Member State that brings them within scope should be subject to the remuneration guidelines.

Q 5: All respondents are welcome to provide their comments on the chapter on proportionality, with particular reference to the change of the approach on 'neutralisations' that was required following the interpretation of the wording of the CRD. In particular institutions that used 'neutralisations' under the previous guidelines for the whole institution or identified staff receiving only a low amount of variable remuneration are asked to provide an estimate of the implementation costs in absolute and relative terms and to point to impediments resulting from their nature, including their legal form, if they were required to apply, for the variable remuneration of identified staff: a) deferral arrangements, b) the pay out in instruments and, c) malus (with respect to the deferred variable remuneration). In addition those institutions are welcome to explain the anticipated changes to the remuneration policy which will need to be made to comply with all requirements. Wherever possible the estimated impact and costs should be quantified, supported by a short explanation of the methodology applied for their estimation and provided separately for the three listed aspects.

FIA EPTA challenges the EBA's radical change of approach on proportionality.

The EBA indicated during the Open Hearing on 8 May 2015 that it finds no support for recital 66[12] in the operative provisions of the legislation. The EBA's legal view is that given the CRD IV remuneration principles themselves must be considered proportionate, a waiver of the application of even a limited set of remuneration principles for smaller and non-complex institutions, when their risk profile allows, would not be in line with the CRD IV. The EBA considers that the '*manner and extent'* wording of Article 92(2) should enable institutions to take different approaches to implement the principles and to vary the intensity with which they apply them, <u>but subject always to achieving the minimum requirements in the principles</u>.

FIA EPTA strongly believes this interpretation is based on an incorrect reading of CRD IV. It is important to note that the text of the proportionality principle in CRD IV is materially the same as that included in CRD III. A change of this principle was therefore not envisaged with the introduction of CRD IV.

First, recitals are included in legislation to guide persons applying provisions therein and do not need support in 'operative provisions'. CRD IV recitals reflect the intent of the co-legislators and cannot be struck out by either the EBA or the Commission. Rather, Member States must apply operative provisions in line with the corresponding recitals.

Second, we disagree with the EBA's assertion that CRD IV contains 'built-in' proportionality. According to the EBA's interpretation that all institutions must apply all provisions, proportionality would only mean that more complex, larger institutions should apply stricter standards than the baseline standards set out in the guidelines. Where principles are specific, such as in relation to the deferral of the payment or vesting of a portion of the variable remuneration (Article 94(1)(m) CRD IV), the EBA's view is that the 'extent' of compliance cannot fall below the figures set out in the principle (i.e. 40% deferral over 3 years) but more complex,

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[12] Recital (66) of CRD IV states that '*The provisions of this Directive on remuneration should reflect differences between different types of institutions in a proportionate manner,* ***taking into account their size, internal organisation and the nature, scope and complexity of their activities.*** ***<u>In particular it would not be proportionate to require certain types of investment firms to comply with all of those principles</u>***.' [our emphasis].

larger institutions need to comply to a greater extent (e.g. by deferring more than 40% over 5 years or more). For less complex, smaller institutions, then, there is no flexibility in the deferral requirement: there is no 'manner' or 'extent' to comply without deferring 40% remuneration. This form of escalating proportionality directly contradicts the wider principle of proportionality established by the Treaty on European Union;[13] proportionality **must** come from application.

Third, the EBA's approach constitutes a radical departure from past practice: we note that recital 4 of CRD III[14] contained equivalent text to recital 66 in CRD IV which expressly provided that "*it may not be proportionate for investment firms referred to in Article 20(2) and (3) of Directive 2006/49/EC to comply with all of the principles.*" Further, recital 9 of CRD III states that in the context of the pay-out process rules, "*the principle of proportionality is of great importance since it may not always be appropriate to apply those requirements in the context of small credit institutions and investment firms.*" Based on such text, CEBS allowed certain firms to treat certain principles as having been neutralised on the basis of proportionality in its guidelines. If it had been the intention of the co-legislators to change this interpretation (given this CEBS guidance was in force during the trilogue process), they could have amended the recitals and changed the operative provisions in CRD IV to state explicitly that the provisions of Articles 92 to 95 were minimum requirements. This was not done, which suggests that CEBS' interpretation and application of proportionality was correct, as we strongly believe.

Fourth, the purpose of CRD IV was to address problems highlighted by the crisis and only establishes a structure for remuneration in order to avoid excessive risk taking. In implementing the CRD, national authorities were tasked with drawing up legislation to conform with the directive while respecting any discretions or derogations. In contrast to the clear legislative aim, the EBA now posits that Member States must apply the remuneration provisions in CRD IV in full, ignoring any discretion concerning proportionality. If the co-legislators had intended the remuneration provisions to be directly applicable as minimum requirements without the need for national legislation, they would have included these in the regulation, and not the directive.

Fifth, the European Commission's current 'Call for advice to the EBA for the purposes of the report on the prudential requirements applicable to investment firms'[15] contains a contradictory view on proportionality to that set out here in the Draft Guidelines. In the context of the review of CRR prudential requirements applicable to investment firms, the Commission states on p. 3, "*depending on the category an investment firm falls into, it may be subject to the same requirements as a credit institution, to modified requirements* ***or it may even be exempt from some or all the requirements***" [emphasis ours]. Further, the Commission foresees the review may encompass "(c) ***potential proportionality (beyond what is already included in the CRR and the CRD)*** in the application of the requirements" (p. 4) [emphasis ours]. There is no reason remuneration would warrant a different treatment than other CRD IV/CRR topics such as capital requirements.

Finally, the EBA acknowledges in its Cost Benefit Analysis for this consultation that requiring all provisions to be applied by all institutions would lead to significant costs and unintended consequences on the structure of the remuneration schemes for small institutions where the level of variable remuneration is low. The same holds true for the impact on firms where the level of variable remuneration is very high, such as in proprietary trading firms.

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[13] All EU law must be proportionate (Treaty on European Union Article 5(4)). The Parliament, Council and Commission are bound by the principle of proportionality.
[14] DIRECTIVE 2010/76/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies ("CRD III").
[15] Ref. Ares(2014)4316869 - 22/12/2014

Below we set out the text regarding the proportionality principle in CRD III and the equivalent text in CRD IV, which should lead to the same treatment (consistent with the CEBS guidelines):

The proportionality principle in the text of CRD III [Recital 9]	*Equivalent text on the proportionality principle in CRD IV [Recital 66]*
The principles should recognise that credit institutions and investment firms may apply the provisions in different ways according to their ***size, internal organisation and the nature, scope and complexity of their activities and, in particular, that it may not be proportionate for investment firms referred to in Article 20(2) and (3) of Directive 2006/49/EC to comply with all of the principles.***	*The provisions … on remuneration should reflect differences between different types of institutions in a proportionate manner, taking into account their* ***size, internal organisation and the nature, scope and complexity of their activities****. In particular* ***it would not be proportionate to require certain types of investment firms to comply with all of those principles****.*

Recitals explain the intent of the Directive and should therefore be read in conjunction with the operative provisions as guidance on how to read and interpret them. FIA EPTA believes that, like Recital 9 in CRD III, which was the basis for CEBS allowing neutralisations, Recital 66 of CRD IV is very clear: not all types of investment firms are required to comply with all of the provisions. In other words certain provisions can be disapplied:

Recital 66 of CRD IV	Interpretation of the EBA and the European Commission
"*In particular,* ***it would not be proportionate to require certain types of investment firms to comply with all of those provisions***".	The EBA consultation states that: *"..the former CEBS [guidelines] allowed for the so-called "neutralisation" of some provisions in smaller and less complex institutions.* ***The terms of [CRD4] do not explicitly grant for such a right****"*.

Moreover, in Article 92(2) of CRD IV, the words *'in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities'* again clearly allow for proportionality. Read in connection with Recital 66 above, applying all provisions without any distinctions would not be appropriate for all firms. In other words, it may be appropriate for certain firms not to apply certain principles at all:

Article 92(2) of CRD IV	Interpretation of the EBA and the European Commission
institutions [should] comply with the … principles ***in a manner and to the extent that is appropriate*** *to their size, internal organisation and the nature, scope and complexity of their activities*	The EBA consultation states that: *"The EBA received confirmation from the EU Commission that Articles 92 and 94 apply to all institutions,* ***without any distinction*** *…".* The European Commission apparently informed the EBA that: ***"the … principles*** *as implicitly referred to in the introductory part of Article 92(2)* ***can in no way justify the non-application of one or the other rule contained in that provision"***

The EBA cites the European Parliament resolution of 3 July 2013 in support of its view, in which the Parliament asks the European Commission and the EBA: '*to ensure full and comprehensive implementation of … the provisions on … remuneration … to continue the reform of* ***banks'*** *… remuneration culture" and 'to ensure … that … remuneration systems at all levels of a* ***bank*** *reflect its overall performance …*' [emphasis ours]. FIA EPTA notes that this statement specifically refers to banks, not investment firms. The reference to banks is understandable, as CRD IV emerged in response to the banking crisis in 2008, after which numerous banks had to be bailed out by national governments and taxpayer funds. This text does not support, rather in our view undermines, the EBA's view that certain categories of investment firms could not disapply some of the remuneration provisions.

Article 94 sets out the requirements with regard to pay out processes as well as the fixed to variable pay ratio. However, Article 94(1) clearly states that the provisions of article "*shall apply under the same conditions as those set out in Article 92(2)*." Therefore, proportionality applies equally to these provisions, in direct contrast to EBA's view that proportionality does not permit neutralisation "*in particular to the provisions referring to the deferral arrangements, the pay-out in instruments and the application of malus*."

Article 92(2) of CRD IV	Interpretation of the EBA and the European Commission
Competent authorities shall ensure that, when establishing and applying the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile, ***institutions comply with the following principles in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities****:*	***In any case****, the limitation of the ratio between the variable components remuneration and the fixed components [ie the bonus cap] …* ***is not subject to proportionality principle****"*
Article 94(1) of CRD IV	
For variable elements of remuneration, the following principles shall ***apply in addition to, and under the same conditions as, those set out in Article 92(2)***	

Q 13: Are the requirements on remuneration policies in section 15 appropriate and sufficiently clear?

In respect to Title IV 'Remuneration policy, award and pay out of variable remuneration for identified staff,' we believe that the provisions of paragraph 178 directly contradict those of paragraph 176 in the context of investment firms engaged solely in proprietary trading. As described in our introductory comments, proprietary trading firms typically pay a limited fixed

base salary, while the variable component of compensation may be relatively high when a trader or firm performance is high, but also low or even zero if performance was less positive or if the trader in question took unnecessary risks or violated policies, rules and regulations. Particularly because of this system, bonuses at proprietary trading firms, regardless of amount, serve as a powerful risk mitigant for excessive risk taking.

Paragraph 183 suggests that there should be no bonus for staff that performs below targets. We note it is notoriously difficult to set targets for staff of trading firms, as their performance may be heavily dependent upon external factors that cannot be predicted. The EBA posits that targets should consist of financial and non-financial targets; however, this could have the unintended impact that traders may forfeit any variable pay if they do not achieve financial targets as a result of external market factors they cannot control. FIA EPTA believes that senior management of trading firms should consider such targets and performance as part of determining variable pay, but that these should not be determinative over management's ultimate discretion.

Q 14: Are the requirements on the risk alignment process appropriate and sufficiently clear?

In general, FIA EPTA believes that the requirements on the risk alignment process are far too prescriptive and as such do not reflect the reality of investment firms engaged solely in proprietary trading. For example, requirements for firms to set long-term performance indicators fail to consider the unpredictable earnings profile of trading firms, and requirements to make ex-ante risk assessments and calculations broken down by business units and different types of risks presuppose a level of complexity among firms that does not always exist. The requirements also generally assume that all firms operate on the basis of long-term risks, which is not the case for proprietary trading firms. In fact most of the criteria in these provisions are not relevant where P&L and risks are locked-in almost immediately and would therefore be impossible to comply with in the manner envisioned by the EBA.

The requirements introduce a highly prescriptive role for control functions throughout the risk alignment process, which similarly fails to differentiate based on the varying nature, scale and complexity of firms within scope. While FIA EPTA supports risk management and compliance functions having appropriate input into setting the remuneration policy for other business areas and allowing significant input into the setting of individual remuneration awards where those functions have concerns about the behaviour of individuals or the riskiness of the business undertaken, we believe the role of control functions is best articulated as a principle following the UK's SYSC 19A Remuneration Principle 5.

We are likewise concerned the text appears to preclude control functions from receiving variable pay that is in any way linked to the firm's overall performance including in terms of earnings. In line with SYSC 19A Remuneration Principle 5, we believe control staff should be remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control, but that further restrictions are unnecessary and disproportionate in the case of proprietary trading firms. Additionally, we do not understand how scoring corporate functions such as legal and human resources against budget metrics supports a firm's assessment of the risk taken by staff members. In fact, we suspect this would incentivise such functions to control costs and as a consequence potentially increase the firm's risk profile.

Q 15: Are the provisions on deferral appropriate and sufficiently clear?

FIA EPTA believes the provisions introduce inappropriately long deferral periods for investment firms engaged solely in proprietary trading. As we have described, due to the nature of electronic trading and hedging in such firms, P&L and any future risks materialise in a manner of days (after delivery of the sold or bought securities). Future risk exposure spanning multiple

years simply does not arise under this business model, unlike in that of banks, asset managers, pension funds or other institutions that have longer-term balance sheet assets and liabilities, often with mismatching terms. Therefore, any deferral period longer than one year would be disproportionate to the risks inherent in the business model of investment firms engaged solely in proprietary trading, while severely limiting the economic rights of the staff eligible for variable pay.

Q 16: Are the provisions on the award of variable remuneration in instruments appropriate and sufficiently clear? Listed institutions are asked to provide an estimate of the impact and costs that would be created due to the requirement that under Article 94(1)(l)(i) CRD only shares (and no share linked instruments) should be used in parallel, where possible, to instruments as set out in the RTS on instruments. Wherever possible the estimated impact and costs should be quantified and supported by a short explanation of the methodology applied for their estimation.

FIA EPTA believes the provisions on the award of variable remuneration in instruments are highly impractical for most investment firms engaged solely in proprietary trading. Where such firms are not organised as partnerships, they will typically be organised as a limited liability company owned by a relatively small number of shareholders. Typically firms do not offer or trade shares to the general public on market exchanges but rather the firm's shares are offered, owned and traded or exchanged privately among a select group of founders and senior staff. It is neither practical nor desirable to force such firms to allocate shares to all staff for the sole purpose of compliance with CRD IV's pay out processes. This would have a material impact on ownership rights of such firms' founders and senior staff.

For those firms who do reward select senior staff in shares, prohibitions on paying any interest or dividends on instruments awarded as variable remuneration gravely infringes upon essential property rights and share characteristics. This would also not be fair from a tax perspective, particularly where shares must be valued at full value at time of award.

Q 18: Are the requirements on the ex post risk adjustments appropriate and sufficiently clear?

FIA EPTA reiterates our general comment that ex post risk adjustments do not suit investment firms engaged solely in proprietary trading. As we have described, due to the nature of electronic trading and hedging in such firms, P&L and any future risks materialise in a manner of days, not years. Therefore, the malus and clawback provisions proposed by the EBA would result in a material, but unnecessary, infringement on firms that have little to no residual risk exposure. It is also unclear what tax impact such provisions would have, particularly where remuneration is made in share instruments subject to potential future deductions.

Q 20: Are the requirements in Title VI appropriate and sufficiently clear?

FIA EPTA notes that requirements and disclosures contained in Title VI of the guidelines are numerous, detailed and potentially onerous or excessive for certain categories of investment firms. We believe it is unequivocal from Level 1 provisions that principles of proportionality are applicable and levels of disclosure are to be commensurate with the nature scale and complexity of an institution. While the draft guidelines acknowledge proportionality within paragraph 288 *("Disclosures should take into account the size of the institution and the nature, scope and complexity of its activities. Small and non-complex institutions should comply with the disclosure requirements by providing information commensurate to their internal organisation and applied remuneration policy."),* much of what follows in Title VI either fails to incorporate or address the application of proportionality or is contrary to the Level 1 requirements. Therefore FIA EPTA believes certain requirements are unwarranted and may lead to an incorrect and narrow application of such principles by stakeholders, national competent authorities and policy makers. Furthermore there is a lack of certainty as to which

stakeholders particular disclosures are to be provided and urge the EBA to clarify that information should be disclosed to a firm's relevant national competent authority.

4. FIA EPTA contact persons:

We sincerely appreciate the opportunity to comment on the Draft Guidelines and look forward to continuing dialogue with the EBA going forward. If you have any questions, or if we can provide further information, please do not hesitate to contact Johannah Ladd at jladd@fia.org.